

OUTLOOK

A Publication of the South Dakota Retirement System

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System Remains Strong

SDRS Investment Performance in the Bear Market

In the last two and a half years, U.S. financial markets have plummeted dramatically from their all-time high. By June 30, 2002, the S&P 500 stock index, a key indicator of stock performance, had lost nearly one third of its total value, pushing the nation into its most severe bear market in decades. While the SDRS Trust Fund has felt the bite of that bear,

the system's reserves have proven to be an effective buffer, keeping SDRS financially strong and enabling it to fare far better than most retirement funds.

SDRS Earnings Reflect Economy

Although the State Investment Office, the agency that manages

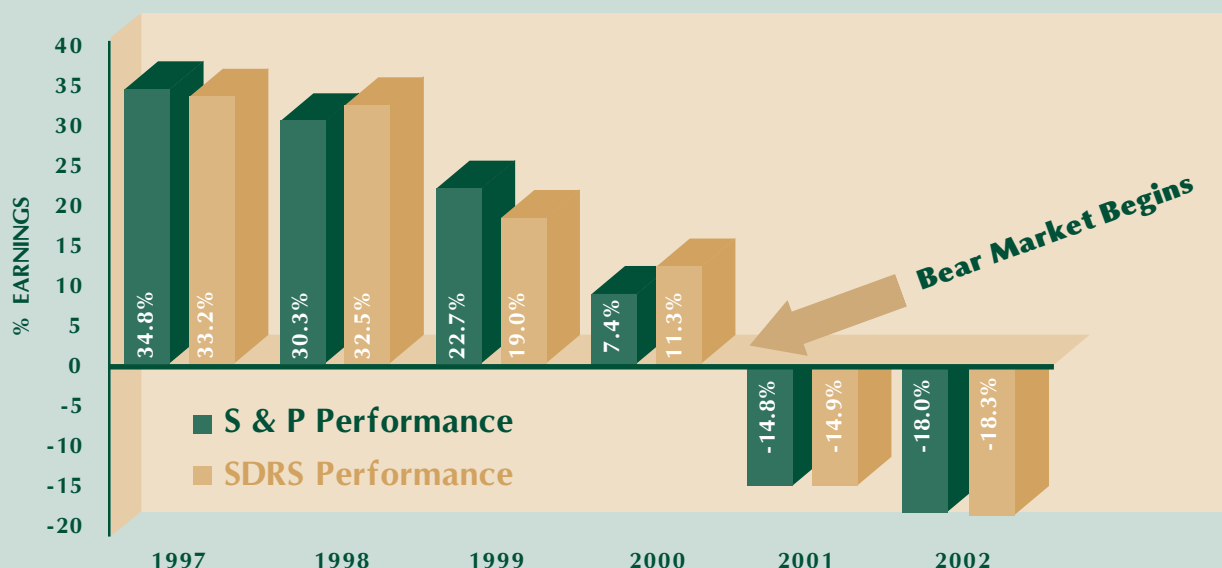
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SDRS Stock Earnings Similar to S & P 500

Performance prior to and during the current bear market, 1997 – 2002



SDRS Investment Performance in the Bear Market ... *continued*

SDRS' investments, has performed well, that performance necessarily reflects conditions on Wall Street. When markets as a whole are on the upswing, SDRS makes money; when markets stumble, our earnings fall just like other investors'.

Consider the boom years of the 1990s. As the chart on page 1 illustrates, the S & P 500 chalked up 34.8 percent in earnings in fiscal year 1997. Similarly, the Investment Office pulled in a hefty 33.2 percent gain on stocks in the SDRS Trust Fund. Earnings the next year were roughly the same: 30.3 percent for the S & P and 32.5 percent for SDRS.

However, as performance started to slide on the S & P at the turn of the century, a downturn occurred in Investment Office returns as well. By fiscal year 2001 earnings tumbled to double-digit lows of -14.8 percent for the S & P and -14.9 percent for the Investment Office's equity fund. This parallel in the two funds' performances continued throughout a difficult fiscal year 2002, with the S & P showing losses of -18.0 percent and SDRS' stocks losing -18.3 percent.

Effect on the Trust Fund

Fortunately, for diversity and balance, the Investment Office buys more than stocks. For example, in fiscal year 2000 only about 36 percent of the system's assets were in equities. Bonds made up a significant portion of SDRS' portfolio (23.1 percent), and

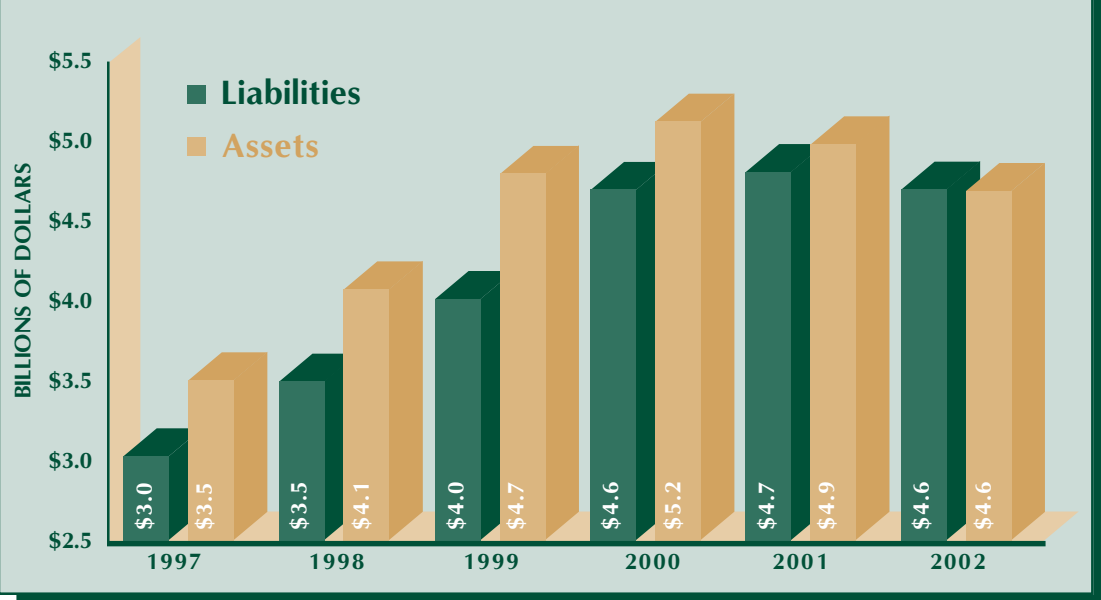
still significant, however. The fund reached its peak at \$5.2 billion in 2000 and fell to \$4.6 billion by June 30, 2002.

System Weathering Storm

Fortunately, SDRS' losses were anticipated after years of exceptional investment returns. In preparation for the inevitable

SDRS Trust Fund Reflects the Bear Market

Liabilities vs. Assets, Fiscal Years 1997 – 2002



international investments, real estate and other holdings comprised another substantial segment.

While the returns on stocks have slid since 1999, bonds earned 10 percent in fiscal year 2001 and 5.9 percent in fiscal year 2002, making up for some of the losses. As a result, the Investment Office was able to weaken the bite of the bear market and to cut its loss to -4.9 percent in fiscal year 2002.

The effect of the declining stock market on the SDRS trust fund was

correction in the market, SDRS created a reserve in 1995. By funding the reserve during years of high earnings (the Investment Office earned 13.9 percent annually for the ten years ended June 30, 2000), SDRS has had the ability to successfully maintain the strength of the system during the market's downturn. As the chart above shows, as of June 30, 2002, SDRS remains fully funded and secure. (For more details on the reserve, see page 5.) **OUTLOOK**

Got a Question?

Making the Most of Your Calls to SDRS

When you call SDRS our goal is for you to reach a real person — not a computerized voice. SDRS thinks that's the best way to promptly connect you to the right staff person with the right answers. Unfortunately, this personal service occasionally becomes impossible.

SDRS' two receptionists handle more than 38,000 calls each year — equivalent to the combined populations of Brookings and Watertown. This would be manageable if the calls were evenly spaced, but, of course, they're not. Calls come in waves, and some times of day are busier than others. The peak times are:

- 12 to 2 p.m.
- 4 to 5 p.m.
- the week after personal benefit statements or issues of *Outlook* are mailed
- the spring retirement season

SDRS addresses this problem of peak times in two ways. First, the telephone system maximizes the possibility that a receptionist will answer each call by transferring the call from one telephone line to the other. This gives each receptionist additional opportunities to pick up. During this time you may hear an

unusual number of rings. If both lines are still busy, the voicemail system is activated and you may leave a message.


Second, to ensure that SDRS responds promptly to messages, the voicemail system is checked every hour. Each message is forwarded to an appropriate staff person, who will try to return your call the same day. However, if you do not have an answering machine, voicemail or caller identification, you may not realize that SDRS has called back.

When you dial SDRS at 605-773-3731 (Monday – Friday 8 a.m. to 5 p.m.), you can help speed your call through the system by using these tips:

- When your call is answered, be ready with your Social Security number and the reason for your call. This information helps the SDRS staff, who will have the account information already on-screen, ready to answer questions as soon as the call is transferred.
- Try to avoid calling during the busiest times of the day, between 12 and 2 p.m. and between 4 and 5 p.m. Central Time.

- If your call is not being answered, wait until the voicemail system starts and then leave a message, including a time during the day when you can be reached if you do not have an answering machine or voicemail.
- Before calling on behalf of someone else, please note that SDRS cannot release account information to anyone other than the member, a person holding a member's power of attorney registered with SDRS or an authorized person designated on SDRS Form D-3, "Authorization for Release of Information."

Finally, keep in mind these quick alternatives to calling:

- The SDRS Web site may contain the answer to your question (<http://www.state.sd.us/sdrs/>).
- You can e-mail your questions to SDRS via the Web site.
- You can e-mail SDRS directly (SDRSWeblink@state.sd.us).
- You can mail your written questions to the Pierre office (PO Box 1098, Pierre, SD 57501-1098). 

SDRS STATE-WIDE MEETING SCHEDULE

SCHEDULE DATE	CITY	COUNTY	LOCATION	ADDRESS
January 7, 2003	Pierre (other than State)	Hughes, Sully, Stanley	Ramkota	920 W. Sioux Ave.
January 14, 2003	Chamberlain	Brule, Buffalo, Lyman	Cedar Shore Resort	1500 Shoreline Dr. (Oacoma)
January 21, 2003	Ipswich	McPherson, Edmunds	Courthouse Comm. Rm.	210 Second Ave.
January 28, 2003	Gregory	Gregory, Tripp	Gregory Auditorium Comm. Rm.	Main St.
February 4, 2003	Watertown	Codington	Ramkota Hotel	1901 9 th Ave. S.W.
February 11, 2003	Hot Springs	Fall River, Shannon	Mueller Civic Center	801 S. 6 th St.
February 18, 2003	Mitchell	Davison, Hanson	Holiday Inn	1525 W. Havens
February 25, 2003	Mission	Todd, Mellette, Bennett	School Curriculum Center	School Campus

Still 100 Percent Funded

How Secure Is SDRS after the Downturn in the Financial Markets?

It's clear that the financial markets have been on a deep slide over the last two and one-half years. The S & P 500 has lost 30 percent since July of 2000. But the effect of the market's collapse on SDRS may be a bit murky to most members.

No Benefit Improvements

Considering the current financial markets, it is doubtful the board will recommend any substantial improvements to SDRS benefits during the upcoming legislative session. In fact, the board has not made a recommendation for substantial increases to benefits since

the downturn in the market began in 2000. The reason: benefit improvements are funded with the additional earnings above 8 percent that come from investing member contributions. If there are no additional earnings from investments, there is no money to pay for new benefits.

The SDRS Reserve Does Its Job

The importance of investment earnings to SDRS financing, however, goes beyond improving benefits. Earnings also cover part of the cost of paying benefits since contributions alone are not sufficient to cover benefit obligations.

According to SDRS' actuary, contributions must be combined with an 8 percent investment return to produce the dollars required to cover the cost of benefits. If investment returns fall below 8 percent, a shortfall occurs that must be made up if SDRS is to remain financially sound.

To protect the system during these inevitable shortfalls, SDRS created a funding reserve in 1995. The system allocates dollars to the reserve in the years when investment earnings are greater than 8 percent. As the chart below illustrates, in fiscal year 1995 SDRS received 14.1 percent on Trust Fund

investments. The first 8 percent was used to cover the cost of standard benefits and the remaining 6.1 percent was placed in the reserve. In subsequent years, the reserve grew large enough to protect the system from shortfalls, which allowed some of the

extra dollars in the reserve to be used for benefit improvements.

At the end of fiscal year 2000, SDRS' reserve was \$536 million. As the markets fell, the reserve functioned precisely as intended — dollars from the reserve covered the

shortfall in investment returns. As a result, as of June 30, 2002, the SDRS reserve balance was -\$29 million. But SDRS was 100 percent funded and continues to be one of the most financially secure systems in the nation. [OUTLOOK](#)

Protection Against Future Losses

The SDRS Reserve: How It Works

In 1995, SDRS created a reserve to protect the financial security of the system and to pay for future improvements of SDRS benefits. Here's how it works.

When investment earnings exceed 8 percent during a fiscal year, the additional dollars flow

into the reserve over the next five years. In principle, the dollars allocated to the reserve are considered for benefit improvements while the dollars allocated to the remaining four years protect the system from a future decline in investment earnings.

However, the decision to increase benefits or keep funds in the reserve for future protection rests on the judgment of the board and the legislature.

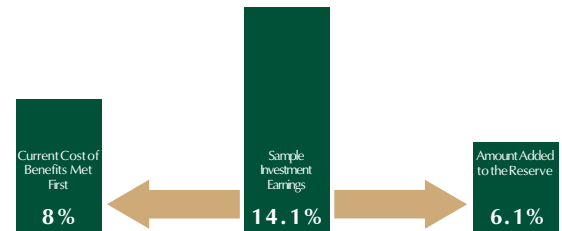
To understand how this works, assume that the year is 2004 and the reserve has

Continued on the following page ...

How Investment Earnings Affect the Reserve

Investment Earnings Above 8% Increase the Reserve

This chart shows that investment earnings are first used to fund the normal cost of benefits. Any earnings over 8 percent are placed in the reserve for funding of Long Term Benefit Goals. These unanticipated earnings are distributed to the reserve over a five-year period.



I: Hypothetical Gain Distribution for 2004

Year	Investment Gain (Loss)	Distribution						
		2004	2005	2006	2007	2008	2009	2010
2004	\$200 M	\$40	\$40	\$40	\$40	\$40		

The SDRS Reserve: How It Works ... *continued*

just been created. Let's also assume that investment earnings for 2004 exceeded the expected 8 percent investment return by \$200 million. As Chart I shows,

no money was spent to improve benefits in 2004 and in 2005 investment earnings again exceeded expectations by \$200 million. As Chart II shows, \$120 million would

the 8 percent expected. Because SDRS realizes any shortfall in the year it occurs, the amount in the reserve would be reduced by \$80 million in 2006. Assuming

II: Hypothetical Gain Distribution for 2005


Year	Investment Gain (Loss)	Distribution						
		2004	2005	2006	2007	2008	2009	2010
2004	\$200 M	\$40	\$40	\$40	\$40	\$40		
2005	\$200 M		\$40	\$40	\$40	\$40	\$40	

that amount would be distributed evenly over five years, \$40 million for each year from 2004 through 2008. The \$40 million allocated to the current year, 2004, could be used to improve benefits. The remaining \$160 million would be available to offset future losses in the markets.

To simplify, let's say that

then be in the reserve — \$40 million allocated to the fund for 2004 but unspent, plus \$80 million new dollars in 2005. Also \$280 million would offset future losses in the markets.

Finally, consider the status of the fund in 2006 (Chart III) if the system were to earn \$80 million less than

no dollars were spent on benefit improvements, in 2006 the reserve would have a total of \$120 million available for benefit improvements (\$40 million from 2004 and \$80 million from 2005). \$200 million would be available to protect the system from future losses. 

III: Hypothetical Loss Realized for 2006

Year	Investment Gain (Loss)	Distribution						
		2004	2005	2006	2007	2008	2009	2010
2004	\$200 M	\$40	\$40	\$40	\$40	\$40		
2005	\$200 M		\$40	\$40	\$40	\$40	\$40	
2006	(\$80 M)			(\$80)				

Coming to See Us?

New Entrance to SDRS Office in Pierre

The concrete is dry, the sawhorses are gone and the glass door is polished. Our new entrance on the east side, at 222 E. Capitol Ave., Suite 8, is

ready to use. SDRS is still in the same building, using the same offices. But now you can park in the east lot on Capitol Avenue and walk right in! **OUTLOOK**

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Board Notes

The following is a summary of major issues that came before the SDRS Board of Trustees at its meeting on September 19, 2002.

SEPTEMBER 19, 2002

Investment Update:

Steve Myers, state investment officer, reported on SDRS' fund returns for the fiscal year to date.

Projections for the Reserve:

Paul Schrader, consulting actuary, provided the board with updated estimates for the Reserve for Funding of Long Term Benefit Goals, as of June 30, 2002.

SRP Investment Alternatives:

Curt Morrow, investment services manager of National Deferred Compensation, reported on the investment

performance of each of the SRP investment alternatives as related to their individual benchmarks.

Member Issues File:

The board reviewed and discussed items in the Member Issues File.

Lawrence County Jailers' Request:

The board reviewed and approved the Lawrence County Jailers' request to become Class B Public Safety members of SDRS.

Trustee Attendance at Board Meeting:

Present: Brian Berglin, Elmer Brinkman, Carol Burch, Tracy Dahl-Webb, Bryan Gortmaker, James Hansen, Royce Hueners, Louise Loban, K.J. McDonald, Dave Merrill, Steve Myers, Pam Roberts, Wes Tschetter, Don Zeller, Sandy Zinter, Steve Zinter

Absent: Lowell Slyter

Interview ... continued

current benefits. So if the system earned 10 percent, only 2 percent would flow into the reserve. And, if the bear market continues for some time in the future, we will also need to make up for all the years we didn't earn 8 percent.

Outlook: Let me stop you there. Are you saying that we need 8 percent in investment earnings every year to pay current benefits, and if the system earns 5 percent we're really down 3 percent?

Zinter: Yes. When we lost 5 percent last fiscal year, we were really 13 percent below what we needed to fund current benefits.

Outlook: So the reserve isn't ever replenished until investment returns exceed 8 percent for a substantial period?

Zinter: That's right. How quickly we are able to consider benefit improvements in the future depends on how well our investments perform long-term.

Outlook: And how well investments perform depends on how well the financial markets are doing.

Zinter: That's also true. While it may seem like international high finance is far removed from South Dakota, we all have a very personal stake in what happens. The collapse of Enron, for example, makes a difference to each of us because SDRS owned Enron stock. It makes a difference when foreign markets go up because we own international stock. In good times and bad, SDRS members are connected to Wall Street and, for that matter, the economy of the world as a whole. **OUTLOOK**

Justice Steve Zinter represents judges, justices and law-trained magistrates on the SDRS Board of Trustees. He has been a member of the board since 1995.



"SDRS' first task will be to rebuild the reserves ..."

OUTLOOK *Interview* Justice Zinter

In 1998, Justice Zinter was interviewed in Outlook during a period in which the financial markets had reached an all-time high. The high was reached in July of that year, followed by a decline of nearly 20 percent in August and another market high in November. The justice's comments four years ago preceded the sustained bear market of the last two and one-half years. Today, he looks ahead to a time when the bull market will again reassert itself on the financial landscape.

Outlook: In 1998, when we were in a strong upward climb in the financial markets, you talked about what might happen to SDRS if the market went into a steep slide. Now that the slide has occurred, I'm wondering if you would comment on what it would mean for SDRS if the performance of stocks and bonds improved significantly.

Zinter: When the bull market returns, and no one knows when that will be, SDRS' first task will be to rebuild the reserves that protected the strength of the system during this difficult time. While I'm pleased that the reserve has worked so well, I'm struck by how deeply the falling market cut into it. In the past two years alone, over \$1 billion was subtracted from the reserve due to investment losses.

Outlook: So even when a bull market returns, members shouldn't expect to see immediate benefit improvements.

Zinter: No, they shouldn't. I want to emphasize that we may still be in a bear market and that there are analysts who argue that there may be more losses coming. At some point, however, conditions will change and we will have strong investment earnings. Even so, that

won't mean immediate benefit improvements, and it could take a number of years of superior investment performance before increases are possible.

Outlook: Why so long?

Zinter: Because we prefund all of our benefit improvements. That means that before we make a change, there has to be enough money in the reserve to pay the full cost of the improvement and to protect the system from future shortfalls.

Outlook: But a year of 10 percent returns would mean \$300 or \$400 million dollars in earnings. Wouldn't that go a long way toward bringing back the reserve?

Zinter: You're missing a critical step. The first 8 percent of SDRS' earnings are already committed to pay for

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